UNITED STATES DISTRICT COURT

DISTRICT OF MAINE

S.D. WARREN CO.,	)	
	)	
Plaintiff	)	
	)	
v.	)	*Civil No. 88-0327 P*
	)	
WILLIAM ENGELMAN, et al.,	)	
	)	
Defendants	)	

RECOMMENDED DECISION ON DEFENDANTS' MOTION FOR JUDGMENT ON THE PLEADINGS

The plaintiff, S.D. Warren Co., claims that several individual and corporate defendants have violated the Racketeer Influenced and Corrupt Organizations Act (``RICO"), 18 U.S.C. ' ' 1961-1968, and have committed various state law torts. According to the plaintiff, the defendants engaged in a commercial bribery scheme in which an S.D. Warren employee and his wife were given kickbacks for arranging to purchase roofing supplies from the defendants on behalf of the plaintiff in unnecessary quantities and/or at inflated prices. On April 19, 1989 this court denied a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6) filed by all the defendants with the exception of Jack Martin.[1] After that decision, the defendants filed answers to the Complaint. Now before the court is the defendants' motion for judgment on the pleadings pursuant to Fed. R. Civ. P. 12(c) as to Counts I through IV of the Complaint.

Section 1964(c) of the RICO statute authorizes suits by ``[a]ny person injured in his business or property by reason of a violation of section 1962 . . . ." Counts I through IV of the Complaint allege

[1] Hereinafter in this recommended decision the term ``defendants" will refer to all the defendants except for Jack Martin.

violations of ' ' 1962(a), (b), (c) and (d) respectively. The defendants argue that Count I fails to state a claim upon which relief can be granted because the plaintiff has not adequately alleged that it was injured by the use or investment of income derived from racketeering, as required by ' 1962(a). They contend that Count II fails to state a claim because the plaintiff has not alleged facts showing that the defendants have acquired or maintained an interest in any enterprise through racketeering. *See* 18 U.S.C. ' 1962(b). In addition, the defendants assert that Count III fails to state a claim under ' 1962(c) because it fails to distinguish the ``enterprise'' from the ``persons'' who used that enterprise to conduct racketeering activity. Finally, the defendants claim that Count IV should be dismissed because there can be no conspiracy to violate ' ' 1962(a), (b) or (c) if no claim under any of these provisions exists.

In response, the plaintiff argues that this court should not consider the defendants' motion because it involves issues which were already raised or which should have been raised in the defendants' previous motion to dismiss, which this court denied on April 19, 1989.[2] The basis for this motion was that the Complaint failed to allege a pattern of racketeering activity and that the allegations of fraud were not pled with sufficient particularity to meet the requirements of Fed. R. Civ. P. 9(b).

Under Fed. R. Civ. P. 12(g),

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[2] Before this case was transferred from the Eastern District of Pennsylvania, the defendants filed a motion in that district to dismiss the complaint for failure to state a claim upon which relief can be granted. Defendants' Motion to Dismiss the Complaint or for Summary Judgment or, Alternatively for Transfer to the Eastern District of Michigan, Southern Division & 2 (Eastern District of Pennsylvania Docket Item #10). As part of their argument in support of this motion, the defendants argued that the ' 1962(c) claim was deficient because the plaintiff did not distinguish the ``person'' from the ``enterprise'' with respect to the business entity defendants. Memorandum of Law in Support of Defendants' Motion to Dismiss the Complaint or for Summary Judgment or, Alternatively for Transfer to the Eastern District of Michigan, Southern Division, p. 11 (Eastern District of Pennsylvania Docket Item #10). Judge Broderick ordered the case transferred to the District of Maine and denied the motion to dismiss without prejudice.

> If a party makes a motion under [Rule 12] but omits therefrom any defense or objection then available to the party which this rule permits to be raised by motion, the party shall not thereafter make a motion based on the defense or objection so omitted, except a motion as provided in subdivision (h)(2) hereof on any of the grounds there stated.

Fed. R. Civ. P. 12(h)(2) states that ``[a] defense of failure to state a claim upon which relief can be granted . . . may be made . . . by motion for judgment on the pleadings, or at the trial on the merits." Rule 12(h)(2) thus exempts the defense of failure to state a claim from the waiver provisions of Rule 12(g). *See* 5 C. Wright & A. Miller, *Federal Practice and Procedure* ' 1392 at pp. 860-61 (1969). I can find no support for the argument that the defendants have waived their right to move for judgment on the pleadings for failure to state a claim because they previously made a motion to dismiss pursuant to 12(b)(6) based on different grounds. Moreover, this motion for judgment on the pleadings is appropriate because it does not simply constitute a delay of trial, but instead raises some dispositive issues.

Count I alleges a violation of 18 U.S.C. ' 1962(a), which reads as follows:

> It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity . . . to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise . . . .

The defendants argue that the plaintiff has not stated a claim for a violation of ' 1962(a) because the injury alleged by the plaintiff resulted from the alleged underlying fraudulent activity rather than from the use or investment of racketeering income.

The plaintiff asserts that it has sufficiently alleged a violation of ' 1962(a) by stating in the Complaint that it has been injured by the defendants' use or investment of racketeering income in seven different enterprises. *See* Complaint && 42, 44, 46, 48, 50, 52 and 54. For example, the

Complaint alleges that: ``S.D. Warren has been injured in its business or property by reason of Defendants' use or investment, directly or indirectly, in acquisition of an interest in, or the establishment or operation of Modern Research." Complaint & 42. According to the plaintiff, the investment of funds in the enterprises made possible the continued operation of these enterprises, and it was injured as a result of that continued operation.

In deciding a motion for judgment on the pleadings, the court ``must accept all of the non-movant's well-pleaded factual averments as true . . . and draw all reasonable inferences in his favor." *Rivera-Gomez v. de Castro*, 843 F.2d 631, 635 (1st Cir. 1988). To grant the motion, it must appear ```beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.'" *Id.*, citing *George C. Frey Ready-Mixed Concrete, Inc. v. Pine Hill Concrete Mix Corp.*, 554 F.2d 551, 553 (2d Cir. 1977) (quoting *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)). Nevertheless, to adequately state a RICO claim, a plaintiff may not merely state in general terms ``that a defendant has violated RICO without the factual allegations necessary to implicate the pertinent provisions of the statute"; quoting the language of the various provisions of ' 1962 in the complaint is not in itself sufficient. *Ortiz Villafane v. Segarra*, 797 F.2d 1, 2 (1st Cir. 1986).

Although the plaintiff has alleged in general terms that it was injured by the investment of racketeering income in several enterprises, it is clear from the Complaint that the specific injury alleged consists of the fraudulent purchase of supplies on behalf of the plaintiff. Construing the well-pleaded allegations in the Complaint in the plaintiff's favor, the Complaint may be read as alleging that income derived from a pattern of racketeering activity was used to sustain the continued operation of the enterprises, which in turn enabled the defendants to use the enterprises to defraud the plaintiff.

A district court within the First Circuit which has addressed the question has ruled that ``' 1962(a) provides a cause of action only for injuries arising from the actual use or investment of

racketeering income, and not for injuries arising from the underlying racketeering activity." *Eastern Corporate Federal Credit Union v. Peat, Marwick, Mitchell & Co.*, 639 F. Supp. 1532, 1537 (D. Mass. 1986). Another court dismissed a claim based on ' 1962(a) for failure to show that the investment of racketeering proceeds proximately caused the plaintiff injury even though the plaintiff claimed that the racketeering money financed general office expenses which permitted continued defrauding of the plaintiff. *De Muro v. E.F. Hutton*, 643 F. Supp. 63, 67 (S.D.N.Y. 1986). *See also Galerie Furstenberg v. Coffaro*, 697 F. Supp. 1282, 1288-89 (S.D.N.Y. 1988) (even if funds invested in enterprise ``enabled defendants to pursue their racketeering activities with enhanced vigor," the injury was caused by the fraudulent activity not the investment itself). *But see Blue Cross of Western Pennsylvania v. Nardone*, 680 F. Supp. 195, 197-98 (W.D. Pa. 1988) (finding allegation of '1962(a) violation sufficient where plaintiff alleged defendant invested racketeering proceeds in pharmacy, which enabled him to use pharmacy to conduct racketeering activity).

I conclude, following *Peat, Marwick, Mitchell & Co.*, that to show an injury caused by the use or investment of racketeering proceeds under ' 1962(a) it is not sufficient to allege that the investment of the money in an enterprise facilitated the defendants' fraudulent activity. Consequently, in this case the plaintiff has not adequately alleged a violation of ' 1962(a).[3]

[3] The plaintiff also incorrectly asserts that, because the individual defendants invoked the Fifth Amendment privilege against self-incrimination in response to the allegations in Count I, they can be considered to have admitted these allegations for purposes of the motion for judgment on the pleadings. *See North River Ins. Co. v. Stefanou*, 831 F.2d 484, 486 (4th Cir. 1987) (properly invoked privilege against self-incrimination avoids rule that failure to deny allegations in pleading constitutes admission).

Count II asserts a violation of 18 U.S.C. ' 1962(b), which declares:

> It shall be unlawful for any person through a pattern of racketeering activity . . . to acquire or maintain, directly or indirectly, any interest in or control of any enterprise . . . .

The Complaint alleges that the ``[d]efendants, through a pattern of racketeering activity, have acquired or maintained, directly or indirectly, an interest in or control of" a number of enterprises. Complaint && 57-63. Based on the specific facts alleged in the rest of the Complaint, it is possible that the plaintiff could prove facts showing that the money obtained by the defendants through their fraudulent kickback scheme was invested in the enterprises for the purpose of maintaining these enterprises -- and thereby their *interest* in these enterprises -- and that the continued operation of the enterprises resulted in the fraud that injured S.D. Warren Co. Nevertheless, these allegations are not sufficient to support a claim of a ' 1962(b) violation. The most the plaintiff has alleged is that investing the proceeds of their fraud enabled the defendants to maintain their interest in the enterprises, which they in turn used to further the fraudulent activity which harmed the plaintiff. As with ' 1962(a), these allegations are not sufficient to state a claim that the plaintiff sustained any injury other than the harm caused by the underlying fraudulent activity.

Moreover, the language of ' 1962(b) prohibits a person from controlling or maintaining an interest in an enterprise through racketeering activity. For example, in *United States v. Local 560 of the International Brotherhood of Teamsters*, 780 F.2d 267 (3d Cir. 1985), *cert. denied*, 476 U.S. 1140 (1986), the court found a violation of ' 1962(b) based on the use of extortion to control membership rights in the union. *See also United States v. Gambino*, 566 F.2d 414 (2d Cir. 1977), *cert. denied*, 435 U.S. 952 (1978) (criminal defendants convicted of violating ' 1962(b) because they maintained control of garbage collection business by beating and threatening to kill competitors). In this case, the plaintiff does not allege any facts suggesting that any of the defendants maintained control of or an interest in

the enterprises through fraudulent activity itself, but instead alleges only that funds obtained through fraudulent activity were invested in the enterprises. I conclude that the Complaint here cannot be construed to allege any facts from which it can be inferred that the plaintiff was injured because the defendants used racketeering activity to acquire or maintain any interest in or control of any of their enterprises, and that therefore Count II fails to state a claim under ' 1962(b).

Count III alleges a violation of 18 U.S.C. ' 1962(c), which states:

> It shall be unlawful for any person employed by or associated with any enterprise . . . to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity . . . .

``[T]he `person' alleged to be engaged in a pattern of racketeering activity (the defendant, that is) must be an entity distinct from the `enterprise;' under ' 1962(c) the enterprise is not liable." *Odishelidze v. Aetna Life & Casualty Co.*, 853 F.2d 21, 23 (1st Cir. 1988). *See Schofield v. First Commodity Corp. of Boston*, 793 F.2d 28, 29 (1st Cir. 1986). A corporation may be a ``person" for purposes of this section, but ``the same corporation may not serve in two roles at the same time." *Schofield*, 793 F.2d at 30. The RICO statute defines ``enterprise" to include ``any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity." 18 U.S.C. ' 1961(4).

The Complaint identifies the following ``enterprises": Modern Research Corporation (``Modern"), Complaint & 67; Lincoln Technical Service, Inc. (``Lincoln"), *id.* & 73; CER Corporation (``CER"), *id.* & 79; ABC Chemical Corporation (``ABC"), *id.* & 85; all the defendants together, *id.* & 91; the defendants, S.D. Warren's employee and S.D. Warren's employee's wife, *id.* & 97; and the defendants and S.D. Warren's employee, *id.* & 103. The ``persons" who were ``employed by or associated with" these enterprises are named as ``[d]efendants, and S.D. Warren's

employee, and S.D. Warren's employee's wife," *id.* && 68, 74, 80, 86, 92, or as ``defendants," *id.* && 98, 104. The defendants are Modern, Lincoln, CER, ABC, and four individuals (William Engelman, Gerald Chernow, Leslie Hayman and Jack Martin). Thus the ``persons" and the ``enterprises" named in Count III overlap to some extent.

In *Roeder v. Alpha Industries, Inc.*, 814 F.2d 22, 28-29 (1st Cir. 1987), the Court of Appeals for the First Circuit held that allegations of a ' 1962(c) violation must be construed flexibly. In that case the complaint alleged that the enterprises consisted of the defendants plus several other entities and individuals ``individually, collectively and in any combination among them." *Id.* Although some of the possible alleged enterprises in that case overlapped with the defendants named as persons, the court reasoned that the complaint could be read in the alternative to allege an enterprise consisting of entities other than the defendants. *Id.* at 29.

In this case, some of the allegations in Count III involve a ``person" who is the same as the alleged ``enterprise." Nonetheless, the Complaint can be construed to adequately allege that each defendant acted as a ``person" separate from an ``enterprise" used to conduct racketeering activity. For example, the first alleged ``enterprise" in Count III is Modern. Complaint & 67. The ``persons" alleged to be associated with that ``enterprise" are ``[d]efendants, and S.D. Warren's employee, and S.D. Warren's employee's wife." *Id.* & 68. This allegation does not state a claim under ' 1962(c) against the defendant Modern because Modern cannot be one of the ``persons" associated with the ``enterprise" Modern. However, the other three corporate defendants and the four individual defendants are ``persons" distinct from the ``enterprise" Modern. The Complaint thus adequately alleges that these defendants conducted the affairs of the ``enterprise" consisting of Modern through a pattern of racketeering activity. Modern does, however, constitute a ``person" separate from Lincoln, the next alleged ``enterprise"; consequently, the Complaint also adequately states a claim of a

' 1962(c) violation against the defendant Modern. Therefore, Count III adequately alleges that each defendant violated ' 1962(c).[4] *See Lumbard v. Maglia, Inc.*, 621 F. Supp. 1529, 1534 (S.D.N.Y. 1985) (defendants may be named as ``person" in some claims and ``enterprise" in others).

Count IV seeks recovery for violation of ' 1962(d), which states:

> It shall be unlawful for any person to conspire to violate any of the provisions of subsections (a), (b), or (c) of this section.

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[4] Moreover, the plaintiff's allegations of overlapping defendants and enterprises could also be considered adequate under the theory that a single entity can be both a ``person" and one of a number of members of an ``enterprise." *Cullen v. Margiotta*, 811 F.2d 698, 729-30 (2d Cir.), *cert. denied sub nom. Nassau County Republican Comm. v. Cullen*, 483 U.S. 1021 (1987); *Dep't of Economic Dev. v. Arthur Andersen & Co.*, 683 F. Supp. 1463, 1481-82 (S.D.N.Y. 1988). The United States Court of Appeals for the Second Circuit has ruled that even though one entity cannot associate with itself for purposes of ' 1962(c), it can still logically be associated with an enterprise of which it is one part. *Cullen v. Margiotta*, 811 F.2d at 729-30. The First Circuit has not addressed this question. A district court within the First Circuit has decided that a corporate defendant cannot be both a ``person" and part of the ``enterprise" consisting of that defendant and an employee of the defendant. *Gaudette v. Panos*, 644 F. Supp. 826, 841 (D. Mass. 1986), *modified on other grounds*, 650 F. Supp. 912, (1987), *rev'd on other grounds*, 852 F.2d 30 (1st Cir. 1988). It is logical that a corporation should not be considered distinct from an entity consisting of that corporation and its employees. In this case, however, the corporate defendants are not simply alleged to participate in an ``enterprise" consisting of the same corporation and its employees, but instead are alleged to participate in enterprises which include other corporations.

It is possible that the plaintiff may be able to prove a conspiracy to violate ' 1962(c). Therefore, Count IV should not be dismissed at this time.

For the foregoing reasons, I recommend that the motion for judgment on the pleadings by the defendants, except for Jack Martin, be ***GRANTED*** as to Counts I and II and ***DENIED*** as to Counts III and IV.

NOTICE

A party may file objections to those specified portions of a magistrate's report or proposed findings or recommended decisions entered pursuant to 28 U.S.C. ' 636(b)(1)(B) for which de novo review by the district court is sought, together with a supporting memorandum, within ten (10) days after being served with a copy thereof. A responsive memorandum shall be filed within ten (10) days after the filing of the objection.

Failure to file a timely objection shall constitute a waiver of the right to de novo review by the district court and to appeal the district court's order.

Dated at Portland, Maine this 29th day of August, 1989.

David M. Cohen
United States Magistrate